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Supreme Court of the United States

OCTOBER TERM, 1935

No. 26

GEORGE W. McCANDLESS, as Receiver of Duquesne Gas Corporation,

Petitioner,

vs.

MAXIME H. FURLAUD, KINGSTON CORPORATION, BYRON CORPORATION, *et al.*

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR RESPONDENTS MAXIME H. FURLAUD, KINGSTON CORPORATION, BYRON CORPORATION and CHAUCER CORPORATION

LOUIS B. EPPSTEIN,
IRA W. HIRSHFIELD,
LOUIS J. ALTKRUG,
Of Counsel.

October, 1935.

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BRIEF FOR RESPONDENTS MAXIME H. FURLAUD, KINGSTON CORPORATION, BYRON CORPORATION and CHAUCER CORPORATION

This case comes before this Court on writ of certiorari granted to the United States Circuit Court of Appeals for the Second Circuit on the 13th day of May, 1935 (R. 275).

The petitioner in his brief has outlined the previous proceedings and has referred to the previous opinion of this Court and the opinions below.

STATEMENT OF THE FACTS

Petitioner contends that there is a vital conflict between the findings of fact by the Trial Court and by the Court

of Appeals. We respectfully insist that this is not true. On page 17 of his brief, petitioner says:

> "The Appellate Court, although stating the facts quite differently from the finding of the Trial Court, nevertheless made no attempt to demonstrate that any finding was erroneous."

Later, on the same page, petitioner says:

> "The error of the Court of Appeals arises chiefly from its misstating a vital fact, viz: that at the time of the closing the defendants 'owned all of the issued Common capital stock of the Duquesne Gas Corporation and all of its bonds and notes' "

We insist that there is no material difference between the facts upon this subject as found by the District Court and by the Court of Appeals.

The undisputed facts are as follows:

Maxime H. Furlaud and Carlos Reuter owned all of the common stock of Furlaud & Company, Inc., a New York corporation (R. 110).

Kingston Corporation, a New Jersey corporation, was a wholly owned subsidiary of Furlaud & Company, Inc. (R. 219).

Kingston Corporation had at great expense acquired options on various properties upon which it had paid various sums of money (R. 51-52). These options were acquired in the latter part of 1929 and the early part of 1930. On February 21, 1930, the Duquesne Gas Corporation which was also a wholly owned subsidiary of Furlaud & Company, Inc. was organized. This corporation originally had an authorized capital structure of one thousand (1,000) shares of no par common stock (R. 220).

In March, 1930, the Duquesne Gas Corporation authorized an increase in the amount of its capital stock and the issuance of $4,000,000 of bonds and $1,000,000 of notes (R. 204, 208, 211-217).

On April 7, 1930, an agreement was entered into between Kingston Corporation and Duquesne Gas Corporation (R. 201-203) by which Kingston Corporation undertook to transfer title to the properties hereinbefore referred to in consideration of Duquesne Gas Corporation agreeing to pay an obligation of Kingston Corporation to the Central Hanover Bank & Trust Company in the sum of $3,015,000, and to deliver to Kingston Corporation 535,000 shares of its no par common capital stock, as well as bonds of the par value of $1,300,000. This proposal was accepted by Duquesne Gas Corporation and was carried out.

About the same time, Furlaud & Company, Inc. proposed to Duquesne Gas Corporation to purchase from it the remainder of the bonds of the par value of $2,700,000 and all of its notes for the sum of 90 per cent. of the face value of the bonds and 88 per cent. of the face value of the notes (R. 217-218). Furlaud & Company, Inc. had also subscribed for 139,000 shares of Duquesne Gas Corporation's stock and agreed to pay therefor the sum of 50 cents a share (R. 211).

Mr. Thomas W. Duke, who on behalf of Chapman & Cutler of Chicago and Chapman, Snider, Duke & Radebaugh of New York, acted as counsel for Furlaud & Company and who took charge of the organization of the Duquesne Gas Corporation and the issuing of its securities, was called as a witness on behalf of the plaintiff. He testified that all of the securities of Duquesne Gas Corporation, the bonds, the notes and the stock were issued to Furlaud & Company or to Kingston Corporation, and that

none of these securities was released to Furlaud & Company or to Kingston Corporation until he was certain that every property that was contracted for had been conveyed to Duquesne Gas Corporation and that the said corporation had $365,000 in its treasury as working capital (R. 84, 86, 88).

All of the testimony upon this subject was introduced by the complainant and is uncontradicted.

Let us now see what were the findings of the Trial Court upon this subject.

Judge Knox, referring to the agreement between the Kingston Corporation and Duquesne Gas Corporation says:

> "This instrument provided that Kingston Corporation would acquire the optioned gas properties then in escrow, and turn them over to Duquesne Gas Corporation. The latter, on its part, agreed to pay $3,015,000 to Central Hanover Bank & Trust Company, the amount which Kingston Corporation would be under obligation to pay to the Trust Company. The Duquesne Company further agreed to issue 535,000 shares of its stock and $1,300,000 face value of its first mortgage six per cent. gold bonds to Kingston Corporation, the bonds to be secured by an indenture, dated March 15, 1930, in which the Trust Company was named as Trustee. On April 9, 1930, the following transactions were had at the offices of Central Hanover Bank & Trust Company:
>
> "Maxime H. Furlaud arranged with the bank that for a period of one day the Kingston Corporation should have a credit of $3,015,000, and that Furlaud & Company, Inc. for a like period of time, should be entitled to a credit of $3,379,500.
>
> "When these credits, which were both closely controlled by the Trust Company, had been set up,

Kingston Corporation delivered its certified checks, in the aggregate amount of $2,449,900 to the Equitable Trust Company, Guaranty Trust Company of New York and Central Hanover Bank and Trust Company, respectively. These checks were intended to put the drawees in funds with which to meet drafts which had been drawn against them by the banks in Western Pennsylvania, which held in escrow the several instruments of conveyance by which the gas properties were to be transferred to Duquesne Corporation * * *. (R. 222).

"The banking institutions which received the checks of Kingston Corporation having made telephonic and telegraphic reports of the payments of the purchase money drafts to the banks holding the escrowed conveyances, the latter were straightway delivered and recorded. *This information, being received, Duquesne Gas Corporation proceeded to issue to Kingston Corporation the 535,000 shares of stock and $1,300,000 face value of bonds which were called for by the agreement of April 7, 1930.* Thereupon, Furlaud & Company, Inc. delivered its check to Duquesne Gas Corporation in the sum of $3,379,500. This was supposed to represent the proceeds which the gas corporation was to receive for $2,700,000 par value of its six per cent bonds, its million dollar issue of gold notes, and 139,000 shares of its capital stock. *All of these securities were contemporaneously delivered to Furlaud & Company, Inc.* * * *" (Italics ours.) (R. 222-223.)

There can be no question but that these securities together with the 1,000 shares of stock originally issued to Furlaud & Company, Inc. were all of the securities ever issued by the Duquesne Gas Corporation. The stock and bonds issued to Kingston Corporation were issued and delivered simultaneously and as part of the same transaction.

Let us now see what was the statement of facts of the Court of Appeals upon these transactions.

The Court of Appeals recited the facts of the transaction between Duquesne Gas Corporation in almost the identical language employed by the lower Court (R. 263-267). It then quoted the following from the opinion of the Trial Court: (R. 388-389)

> "At the time that the transaction through which Duquesne Gas Corporation acquired the various gas properties were consummated, and for some time thereafter, Furlaud & Company, Inc. owned every share of its capital stock, and ratified and approved of the whole transaction."

Then follows the language complained of by the petitioner:

> "At the end of these transactions, the two corporations, Furlaud & Company, Inc. and its subsidiary, Kingston Corporation, owned all of the issued common capital stock of the Duquesne Gas Corporation, and all of its bonds and notes. No other person purchased from Duquesne Gas Corporation a share of stock, a bond or a note" (R. 268).

There is no question about the actual facts in this case. They are correctly stated by the Trial Court and by the Court of Appeals.

Petitioner, however, throughout his brief, contends that the properties acquired by Duquesne Gas Corporation were actually paid for out of the money received from the sale by Furlaud & Company, Inc. of Duquesne Gas Corporation securities. In this he differs from the findings of both Courts and from the testimony of Thomas W. Duke, peti-

tioner's own witness upon this subject (R. 84-88). The properties were paid for out of monies furnished by Furlaud & Company, Inc. to its wholly owned subsidiary, Kingston Corporation (R. 81).

Moreover it seems to us to be too clear to justify extended argument that the petitioner's version of the facts could not possibly be true. What Furlaud & Company, Inc. agreed to sell and did sell to the distributing group were issued bonds (R. 178). These bonds could not possibly have been issued and validated until the properties acquired by Duquesne Gas Corporation had been paid for, and the deeds delivered to Duquesne Gas Corporation, and until such deeds and the mortgages securing the bonds and notes (which had been executed in advance) had been recorded; and, even then, not until after Furlaud & Company, Inc. had paid, for the remaining bonds, notes and stock, an amount sufficient to pay the obligation of Kingston Corporation to the Central Hanover Bank & Trust Company and leave in the treasury of Duquesne Gas Corporation the sum of $365,000 as working capital (R. 88).

Until all of these things had been completed, no bonds could have been validated by the trust company and legally released either to Kingston Corporation or Furlaud & Company, Inc. or to any one else. Thomas W. Duke testified that not until all these things had been done were any securities released (R. 88) and so both Courts found (R. 223, 265-266).

It is true that after these bonds had been issued some of them were sold by Furlaud & Company, Inc. to people who had previously agreed to purchase them from it when, as and if issued, and that the proceeds of such sales were used by Furlaud & Company, Inc. to pay off part of the loan due by it to the Central Hanover Bank & Trust Company.

There is in the record only one fact concerning which the findings of the Trial Court and that of the Court of Appeals do not agree, namely, the amount received by Furlaud & Company, Inc. from the sale of the bonds on April 9th, 1930. This amount was fixed by the Trial Court at $3,000,000 (R. 223) and by the Court of Appeals at $1,886,330 (R. 266). The amounts credited to Furlaud & Company's bank account from the sale of bonds were, at the request of the Trial Court, reported to the Court by the witness Halporn who testified from the books of Furlaud & Company, Inc. (R. 128-129), which were in Court and which were offered in evidence (Plaintiff's Exhibits 29 and 30, R. 94, 200). There was at that time present in court Mr. Roger A. McShea, Jr., an accountant employed by the Pennsylvania Public Service Commission, who had made an extensive survey of Furlaud & Company's books (R. 92-93). There was also present an Assistant Vice-President of the Central Hanover Bank & Trust Company who could, at a moment's notice, have verified or disputed the correctness of these figures by merely securing from the bank a statement of the amounts deposited (R. 90-91).

How then did the error of the learned Trial Court occur? The only other testimony upon this subject was that of Eugene P. Brady, a former salesman for Furlaud & Company, Inc., who testified that he was employed to secure commitments for the sale of the bonds of the Duquesne Gas Corporation (R. 73) and that the bond issue was not fully subscribed for (R. 76). When asked to what extent it was subscribed for, he said: "That I would not know, but I should say somewhere in the neighborhood of 75 to 80%" (R. 76). He nowhere testified as to what subscriptions were obtained before nor what amounts were taken up on

April 9, 1930. However, he makes it very clear that not more than eighty per cent. of the bonds were ever subscribed for by the primary group. A secondary group was organized about August 14, 1930 (R. 198-199) and that at that time "I guess there were some $800,000 in bonds left" (R. 103); so that at most the testimony of this witness was to the effect that, between the day of the original offering and approximately August 14, 1930, about eighty per cent. of the bonds had been subscribed for and that the remaining $800,000 were handled through a secondary distributing group and his testimony makes it very clear that he had no real knowledge of the facts.

SUMMARY OF POINTS AND ARGUMENT

1. The facts alleged in the complaint do not show that Duquesne Gas Corporation had a cause of action against any of these defendants.

2. The Trial Court erred in permitting the complainant to introduce testimony tending to show alleged misrepresentations made by Fur[illegible]aud & Company, Inc. to purchasers of securities from it.

3. Notwithstanding the fact that purchasers of securities to whom material misrepresentations might have been made by their vendors and who might have relied thereon to their harm would indubitably have a cause of action against the vendors of such securities, respondent contends that under the facts disclosed in this case neither the Duquesne Gas Corporation nor its receiver could have been injured or could have acquired a cause of action as a result thereof.

4. Under the facts of this case the plaintiff in his capacity of receiver has no greater rights or powers than the corporation itself would have.

5. The contention of the petitioner that the corporation was powerless to render itself insolvent by surrender to the defendants of its right to hold them accountable to it for the proceeds which came into the hands of defendants from the sale of the securities of the corporation, is not only not within the issues presented by the complaint, but under the facts of this case is unsound.

6. The question presented by petitioner under Point VI of his brief, having been raised for the first time upon the second argument of the appeal of this case, could not in any event be considered because

(1) There is no allegation in the complaint under which this issue, if sound, could have been raised;

(2) It is in direct conflict with the theory upon which the case was tried in the lower court.

7. The Trial Court properly dismissed the complaint as to the defendants Byron Corporation and Chaucer Corporation.

8. The defendant Furlaud is not personally liable in this case in any event.

9. The complaint affirmatively shows that complainant had no title to any cause of action that could have been asserted by Duquesne Gas Corporation.

POINT I

THE FACTS ALLEGED IN THE COMPLAINT DO NOT SHOW THAT DUQUESNE GAS CORPORATION HAD A CAUSE OF ACTION AGAINST ANY OF THESE DEFENDANTS.

We shall paraphrase the allegations contained in the complaint.

The first seven paragraphs (R. 4-6) are devoted to allegations showing the jurisdiction of the Court in relation to the parties, that Carlos Reuter and Maxime H. Furlaud owned all of the stock of Furlaud & Company, Inc., that Furlaud & Company, Inc. was an investment banking house which in turn owned all of the stock of Kingston Corporation and through Kingston Corporation acquired options on certain properties in Pennsylvania, that after the options had been acquired Furlaud & Company, Inc. caused another corporation, Duquesne Gas Corporation, to be organized and that then Furlaud & Company, Inc. owned all of the stock issued by that corporation, that Duquesne Gas Corporation authorized the issuance of secured bonds in the face amount of $4,000,000 and secured notes in the face amount of $1,000,000, and 675,000 shares of no par value stock.

The "Eighth" paragraph (R. 6-7) alleges that Furlaud & Company, Inc., as a banking house of issue, made a public offering of the bonds and notes and stated in the bond and note circulars that the securities were (or are) issued by the corporation in connection with the acquisition of properties and to provide cash for development, extensions and other corporate purposes. THERE IS NO ALLEGATION ANYWHERE IN THE COMPLAINT THAT THESE REPRESENTA-

TIONS OR, IN FACT, ANY REPRESENTATIONS THAT WERE MADE, WERE NOT IN ALL RESPECTS TRUE.

The "Ninth" paragraph (R. 7) alleges that Furlaud & Company, Inc. had arranged for the acquisition by Duquesne Gas Corporation of various properties, the aggregate price being $2,572,989, that the properties were to be conveyed to Duquesne Gas Corporation in consideration of the payment by Duquesne Gas Corporation of said sum and that such sum was paid out of the proceeds of the sale of the bonds and securities.

The "Tenth", "Eleventh", "Twelfth" and "Thirteenth" paragraphs (R. 7-9) are devoted to showing the amount for which the securities were sold and that the difference between that amount, and the cost of the property and $365,000, was retained by Furlaud & Company, Inc. and/or some of the defendants.

The "Fourteenth" (R. 9) merely alleges that these defendants or some of them stood in a fiduciary relationship to Duquesne Gas Corporation.

The "Fifteenth" (R. 9) summarizes the mathematics of all of the transactions referred to.

Unless, therefore, the "Eighth" paragraph of this complaint can be so construed as to allege that Furlaud & Company, Inc. were disposing of the securities as agents of Duquesne Gas Corporation, there is nothing in this complaint that could be construed as alleging a cause of action against any one. Attention is called to the fact not only that no such allegation is made in these paragraphs of the complaint but that on the contrary in this paragraph Furlaud & Company, Inc. is described as a house of issue.

A house of issue is, of course, a house which having purchased or underwritten a security first offers it for sale to the public. Sometimes corporations offer their own securities directly to the public and employ banking houses

to make the offering for them, but in such cases the banking house is not acting as a house of issue but as an agent or broker.

However, complainant was not content to stand on the first fifteen paragraphs of his complaint, but in the "Sixteenth" paragraph (R. 9-12) he entered into a detailed categorical statement of the steps by which the transaction was carried into effect. This paragraph completely negatives any theory that Furlaud & Company, Inc. was acting as agent for Duquesne Gas Corporation in selling securities or that Duquesne Gas Corporation purchased the properties from any one other than Kingston Corporation.

The "Sixteenth" paragraph shows that Kingston Corporation acquired options for the purchase of various properties, that Furlaud and Reuter caused Duquesne Gas Corporation to enter into a contract with Furlaud & Company, Inc. for the sale by Duquesne Gas Corporation to Furlaud & Company, Inc. of $2,700,000 of its bonds and $1,000,000 of its notes, that an agreement of reorganization between Duquesne Gas Corporation and Kingston Corporation was executed and under said agreement Kingston Corporation agreed to convey said property to Duquesne Gas Corporation and Duquesne Gas Corporation agreed to pay $3,015,000, stated to be the amount which Kingston Corporation would be obligated to pay to Central Hanover Bank & Trust Company, and to issue and deliver to Kingston Corporation 535,000 shares of its common stock and $1,300,000 in principal amount of its 6% Mortgage Convertible Gold Bonds, and that Kingston Corporation declared a dividend in kind to its stockholders (Furlaud & Company, Inc.) of said $1,300,000 in face amount of bonds.

In other words, the plaintiff alleges in effect that Furlaud & Company, Inc. purchased the $1,000,000 in notes,

$2,700,000 in bonds, and 140,000 shares of stock at a price that is nowhere challenged by the petitioner, and that Kingston Corporation transferred to Duquesne Gas Corporation property which cost it $2,572,989, in consideration of the assumption by Duquesne Gas Corporation of a debt of Kingston Corporation amounting to $3,015,000 and the issuance to Kingston Corporation of bonds of the face value of $1,300,000 and 535,000 shares of common stock of no par value.

There is even no allegation in the complaint that the property conveyed by Kingston Corporation to Duquesne Corporation was not fairly worth the amount paid for it by Duquesne Gas Corporation.

Obviously this complaint affirmatively shows that Furlaud & Company, Inc. and its wholly owned subsidiary, Kingston Corporation, on the one hand, entered into an agreement with Duquesne Gas Corporation, which, at the time of the agreement, was a wholly owned subsidiary of Furlaud & Company, Inc., by the terms of which Duquesne Gas Corporation acquired certain property and certain monies and in exchange therefor agreed to, and did deliver to Furlaud & Company and Kingston Corporation all of its stock that was ever issued and all of its securities that were ever issued. The complainant alleges that Furlaud & Company, Inc., sold these securities, but there is no allegation in the complaint that in making these sales they made any misrepresentation of any kind to the purchasers of the securities.

We respectfully insist that the facts alleged in this complaint do not constitute a cause of action of any kind.

As we discuss the questions of law involved under Point III of this brief, we refer to our argument there in support of our contention here.

POINT II

THE TRIAL COURT ERRED IN PERMITTING THE COMPLAINANT TO INTRODUCE TESTIMONY TENDING TO SHOW ALLEGED MISREPRESENTATIONS MADE BY FURLAUD & COMPANY, INC. TO PURCHASERS OF SECURITIES FROM IT.

Attention of this Court is called to the following facts:

1. After the amended complaint was served in this case the defendants, Maxime H. Furlaud and Kingston Corporation, made an application under Equity Rule 20 to require the complainant to make a further and better statement of the nature of his claim by setting forth definitely and specifically the ultimate facts upon which it was claimed (1) that the defendants Furlaud and Reuter caused the proceeds of the sale of the bonds and notes to be diverted from the Duquesne Gas Corporation and (2) that the defendants fraudulently misappropriated funds and diverted monies from the proper uses of the Duquesne Gas Corporation (R. 13-15).

This motion was opposed by the solicitors for the complainant. In the affidavit submitted by Mr. Ralph Royall, the deponent states: "It is submitted that a reading of the amended bill of complaint will show that, although the proceedings taken by these defendants in diverting and misappropriating the assets of Duquesne Gas Corporation were involved and elaborate, they are clearly set forth in chronological order.. It is also submitted that such facts so alleged can bear only the ultimate inference that the defendants stood and stand in a fiduciary relationship to the defendant Duquesne Gas Corporation and that in such relationship

they are accountable to the corporation and to its Receiver for all the monies coming into their hands or the hands of any of them from the sale of the securities of Duquesne Gas Corporation, and the bill alleges such fiduciary relationship" (R. 26).

So it appears that complainant, after having been given this opportunity to again amend his complaint, elected to stand on his complaint as filed.

Attention is further called to the fact that the amended bill of complaint does not contain a single allegation to the effect that there was any overvaluation of the properties acquired by Duquesne Gas Corporation or that any misrepresentations of value or of anything else were made to anyone.

2. The opinion of the Trial Court is based upon his findings that the circulars and the advertisements appearing in the New York Times relating to the bonds and the notes of the Duquesne Gas Corporation stated that the property of the Corporation had an aggregate appraised value (including working capital of $365,000) amounting to $7,038,000 (R. 224) although certain of the properties which were appraised by the firm of Mattison, Davey & Winters at $4,929,787 cost only $1,200,000 and were greatly overvalued (R. 220); and, finally, that the value of the properties were grossly and fraudulently misrepresented to the public (R. 224).

The entire decision of the Trial Court is based on the theory that the purchasers of the bonds and notes of the Duquesne Gas Corporation must have been misled by the so-called misrepresentations of the value of the properties of the Duquesne Gas Corporation. One would conclude from the opinion that the gravamen of the complaint was

the misrepresentations set forth above and that allegations with respect thereto were set out in the bill of complaint.

The only reference in the complaint to any statement in the circulars issued in connection with the distribution of the bonds and notes appears in paragraph "Eighth" and it is merely alleged that it was stated in said circulars that the bonds and notes were (are) issued by the corporation in connection with the acquisition of properties and to provide cash for development, extensions and other corporate purposes (R. 7).

There is no allegation that these statements were false or that they were material or that they misled any one.

Nowhere in the amended complaint is there a single allegation which has been held to be an essential part of actionable fraud.

It is evident that the theory of the complainant's case, as set forth in the amended complaint, is not based on any claimed misrepresentations of facts or overvaluation of properties. Any such theory was a pure afterthought of the pleader. The complainant's solicitors repeatedly insisted and the Court found that the gravamen of their suit was that the securities of Duquesne Gas Corporation came into their hands in a fiduciary capacity and that a large portion of the funds received by the defendants from the sale of such securities was diverted and misappropriated from the treasury of the Duquesne Gas Corporation (R. 219).

Not a suggestion was ever made, until after the trial was in progress, that any claimed misrepresentation furnished the gravamen of the cause. No such interpretation can be spelt out of the amended complaint.

At the trial, however, the complainant produced Charles C. Nuss, Walter C. Krog, Lyon F. Terry and Cyrus C. Robbins and through them introduced evidence tending to prove that the appraisal contained in the circulars and the advertisements appearing in the New York "Times" relating to the bonds and notes of Duquesne Gas Corporation had been fraudulently made and grossly overvalued the properties. This testimony tended to show that the fair market value of the property was much less than that set out in the appraisal and that the property cost even less than that. All of this testimony was strenuously objected to by the defendants (R. 57-60, 61, 62, 63, 109, 113).

The objections and exceptions were so numerous that counsel for complainant three times stated that defendant would be considered as having a general objection to all testimony of this general character (R. 53, 54, 69) and the Court stated (R. 113):

> "Yes, you may have an exception to this line of testimony".

The defendants pled surprise and stated to the Court that they were not prepared to meet the testimony upon this issue (R. 60) and generally did everything they could do to protect themselves against the introduction of the testimony.

If the complaint in this case states a cause of action at all, which we greatly doubt, it is a cause of action based either upon the contention that Furlaud & Company, Inc. and Kingston Corporation were acting as trustees or agents for Duquesne Gas Corporation in acquiring the properties transferred to it, and as such agents or trustees were under the obligation to turn the properties over to the corporation at cost, or that the bonds and notes issued by the corpora-

tion were entrusted to them as agents for sale and that they had failed to account.

Under neither of these theories was any such testimony relevant, material, or competent. If the defendants, or any of them, were acting as agents for Duquesne Gas Corporation in disposing of these securities, they were, of course, obliged to account for the proceeds of the sale of such securities.

If the defendants, or any of them, were merely acting as agents for Duquesne Gas Corporation in purchasing the properties for it, they were, of course, under obligation to turn the properties over to Duquesne Gas Corporation without making any secret profits upon the transaction. That they could have made no secret profits indubitably appears from the fact that Furlaud & Company, Inc. owned Duquesne Gas Corporation. It, Duquesne Gas Corporation, was not organized until *after* these options had been acquired and, when organized, was completely owned by Furlaud & Company, Inc. There could, of course, have been no secret profits as any transaction between Furlaud & Company, Inc. and Duquesne Gas Corporation, which was a mere instrumentality of Furlaud & Company, Inc.

The learned Trial Court did not in express terms overrule the decision of this Court in *Old Dominion Copper Co. v. Lewisohn*, 210 U. S. 206. In fact, in part he recognized its binding force (R. 232).

He did, however, base his opinion upon the theory that misrepresentations made to the purchasers of securities by the promoters of a corporation who had acquired them from the corporation in the manner that these were acquired created an obligation which, even if the corporation itself could not enforce, its Receiver in his representative capacity could. As we discuss this question of law elsewhere,

we shall make no comment upon it here further than to say that it demonstrates the proposition that, since this testimony was not admissible, it was extremely prejudicial. We are forced to ask where in the Complaint is there any allegation under which this testimony could be admitted. If this testimony were eliminated from this record, is it not obvious that no one would have had the slightest cause for complaint?

No principal of equity jurisprudence is more firmly fixed than that, as in law, so in equity, the *allegata* and *probata* must correspond and that the plaintiff, in equity, cannot recover if his proof does not harmonize with the allegations in his bill. In equity proceedings a party is not allowed to state one case in his pleadings and make out a different one in his proof. Averments without proofs and proofs without averments are alike unavailing. Any other rule would do away with the necessity for pleadings, and lead to surprise and unfairness on the trial.

In the case of *Foster* v. *Goddard,* 1 Black 506, the Supreme Court of the United States, per Mr. Justice Swayne, said (p. 518):

> "In equity proceedings the proofs and allegations must agree. A party can no more succeed upon a case proved, but not alleged, than upon a case alleged, but not proved. *Simms* v. *Guthrie,* 9 Cranch 19; *Harrison* v. *Nixon,* 9 Pet. 483; *Boone* v. *Chiles,* 10 Pet. 178; *Trip* v. *Vincent,* 3 Barb. C. H. 613; *Bank of U. S.* v. *Shultz,* 3 Ohio R. 61; *Sadler* v. *Glover,* 5 Dana 552; *Breckenridge* v. *Ormsby,* 1 J. J. Marsh 236."

In *Harrison* v. *Nixon,* 9 Pet. 483, Mr. Justice Story stated (p. 503):

"Every bill must contain in itself sufficient matters of fact, *per se,* to maintain the case of the plaintiff; so that the same may be put in issue by the answer, and established by the proofs. The proofs must be according to the allegations of the parties; and if the proofs go to matters not within the allegations, the court cannot judicially act upon them as a ground for its decision; for the pleadings do not put them in contestation. The *allegata* and the *probata* must reciprocally meet and conform to each other."

In the case of *Crocket* v. *Lee,* 7 Wheat. 522, Mr. Chief Justice Marshall, in discussing a similar situation, said (p. 526):

"The counsel for the appellant says it would be monstrous, if, after the parties have gone to trial on the validity of the entry, and have directed all their testimony in the Circuit Court to that point, their rights should be made to depend in the appellate court on a mere defect in the pleadings, which had entirely escaped their observation in the Court where it might have been amended, and the non-existence of which would not have varied the case.

"The hardships of a particular case would not justify this tribunal in prostrating the fundamental rules of a court of Chancery—rules which have been established for ages, on the soundest and clearest principles of general utility. If the pleadings in the cause were to give no notice to the parties or to the Court of the material facts on which the right asserted was to depend, no notice of the points to which the testimony was to be directed, and to which it was to be limited; if a new case might be made out in proof, different from that stated in the pleadings, all will perceive the confusion and uncertainty which would attend legal proceedings, and the injustice

which must frequently take place. The rule that the decree must conform to the allegations, as well as to the proofs of the parties, is not only one which justice requires, but one which necessity imposes on Courts."

In *Garrett* v. *Louisville & N. R. Co.*, 235 U. S. 308, at page 312, this Court says:

"Where any fact is necessary to be proved in order to sustain the plaintiff's right of recovery, the declaration must contain an averment substantially of such fact in order to let in the proof. Every issue must be founded upon some certain point, so that the parties may come prepared with their evidence, and not be taken by surprise, and the jury may not be misled by the introduction of various matters. *Bank of United States* v. *Smith*, 11 Wheat. 171, 174 6 L. Ed. 443, 444; *Minor* v. *Mechanics' Bank*, 1 Pet. 46, 67, 7 L. Ed. 47, 56; *De Luca* v. *Hughes*, 96 Fed. 923, 925; *Rose* v. *Perry*, 8 Yerg. 156; *Citizens' Street R. Co.* v. *Burke*, 98 Tenn. 650, 40 S. W. 1085, 2 Am. Neg. Rep. 459; 1 Chitty, P. 270. Although the same precision of statement is not required as in pleadings at law, nevertheless it is held to be absolutely necessary that in bills of equity such a convenient degree of certainty should be adopted as may serve to give the defendant full information of the case which he is called upon to answer. Every bill must contain in itself sufficient matters of fact, *per se*, to maintain the plaintiff's case; and if the proofs go to matters not set up therein the court cannot judicially act upon them as a ground for decision, for the pleadings do not put them in contestation. *Harrison* v. *Nixon*, 9 Pet. 483, 503, 9 L. Ed. 201, 208; Dan. Ch. P. & Pr. 368."

"The plaintiff's declaration contains no positive averment of pecuniary loss to the parents for whose

benefit the suit was instituted. Nor does it set out facts or circumstances adequate to apprise the defendant with reasonable particularity that such loss in fact was suffered."

See also:

Henry v. *Suttle,* 42 Fed. 91;
Dashiell v. *Grosvenor,* 66 Fed. 334;
Finefrock v. *Kenova Mine Car Co.,* 22 Fed. (2d) 627, at page 634;
Babbitt v. *Dotten,* 14 Fed. 19.

We respectfully submit that the Trial Court committed reversible error in receiving and considering this testimony.

POINT III

NOTWITHSTANDING THE FACT THAT PURCHASERS OF SECURITIES TO WHOM MATERIAL MISREPRESENTATIONS MIGHT HAVE BEEN MADE BY THEIR VENDORS AND WHO MIGHT HAVE RELIED THEREON TO THEIR HARM WOULD INDUBITABLY HAVE A CAUSE OF ACTION AGAINST THE VENDORS OF SUCH SECURITIES, RESPONDENT CONTENDS THAT UNDER THE FACTS DISCLOSED IN THIS CASE NEITHER THE DUQUESNE GAS CORPORATION NOR ITS RECEIVER COULD HAVE BEEN INJURED OR COULD HAVE ACQUIRED A CAUSE OF ACTION AS A RESULT THEREOF.

Statement of Facts

No controversy exists as to the actual facts involved. They are uncontradicted in the evidence. They are recited

in the findings of the Trial Court and in those of the Court of Appeals.

They are substantially as follows:

Furlaud & Company, Inc. was engaged in the business of buying and selling corporate securities (R. 219).

Kingston Corporation was a wholly owned subsidiary of Furlaud & Company, Inc. (R. 113). In the Fall of 1929 and early in 1930, Kingston Corporation acquired options upon nine gas properties located in Western Pennsylvania and elsewhere. The agreed purchase price of these properties amounted to $2,572,989 (R. 51-52, 59).

Subsequently and on February 21st, 1930, Duquesne Gas Corporation was organized by Furlaud & Company, Inc. with an original authorized capital of 1,000 shares of no par value (R. 22). This stock was subscribed for and acquired by Furlaud & Company, Inc. for the sum of $500 in cash.

Thereafter, on or about March 5th, 1930 Duquesne Gas Corporation "the entire capital stock of which was held by Furlaud & Company, Inc. or its nominees, authorized issue of four million dollars of six per cent. gold bonds, and the one million dollars of 6½ per cent. notes, to be secured respectively by first and second mortgages upon its properties. The company's authorized capital was also increased from 1,000 to 675,000 shares, without par value" (Judge Knox's opinion, R. 221).

> "On April 7, 1930, Duquesne Gas Corporation and Kingston Corporation entered into what was termed an 'Agreement of Reorganization.' This instrument provided that Kingston Corporation would acquire the optioned gas properties then in escrow, and turn them over to Duquesne Gas Corporation.

The latter, on its part, agreed to pay $3,015,000 to Central Hanover Bank & Trust Company, the amount which Kingston Corporation would be under obligation to pay to the Trust Company. The Duquesne Company further agreed to issue 535,000 shares of its stock and $1,300,000 face value of its first mortgage six per cent. gold bonds to Kingston Corporation, the bonds to be secured by an indenture, dated March 15, 1930, in which the Trust Company was named as Trustee. *On April 9, 1930, the following transactions were had at the offices of Central Hanover Bank & Trust Company:*

Maxime H. Furlaud arranged with the bank that for a period of one day the Kingston Corporation should have a credit of $3,015,000, and that Furlaud & Company, Inc. for a like period of time, should be entitled to a credit of $3,379,500.

"When these credits, which were both closely controlled by the Trust Company, had been set up, Kingston Corporation delivered its certified checks, in the aggregate amount of $2,449,900 to the Equitable Trust Company, Guaranty Trust Company of New York and Central Hanover Bank and Trust Company, respectively. These checks were intended to put the drawees in funds with which to meet drafts which had been drawn against them by the banks in Western Pennsylvania, which held in escrow the several instruments of conveyance by which the gas properties were to be transferred to Duquesne Gas Corporation * * *" (italics ours) (Judge Knox's opinion, R. 222).

"The banking institutions which received the checks of Kingston Corporation having made telephonic and telegraphic reports of the payments of the purchase money drafts to the banks holding the escrowed conveyances, the latter were straightway delivered and recorded. This information, being re-

*ceived, Duquesne Gas Corporation proceeded to issue to Kingston Corporation the 535,000 shares of stock and $1,300,000 face value of bonds which were called for by the agreement of April 7, 1930. * * *"* (Judge Knox's Opinion, R. 222-223) (Italics ours).

In order to provide the funds required for the closing and marketing operations, Furlaud & Company, Inc. borrowed on three time loans the aggregate additional amount of $1,500,000, to wit, $700,000 from the Chatham & Phoenix National Bank & Trust Company, $500,000 from the Pacific Trust Company and $300,000 from the Hibernia Trust Company. Some of these sums so borrowed were immediately credited to Furlaud & Company's account at the Central Hanover Bank & Trust Company (R. 114).

As a result of these transactions, Kingston Corporation transferred substantially all of its properties to Duquesne Gas Corporation, receiving in exchange therefor 535,000 shares of the common capital stock of Duquesne Gas Corporation, first mortgage bonds of Duquesne Gas Corporation of the face value of $1,300,000 and Duquesne Gas Corporation assumed Kingston Corporation's obligation to the Central Hanover Bank & Trust Company in the sum of $3,015.000.

Concurrently, Furlaud & Company, Inc. purchased from Duquesne Gas Corporation the remaining $2,700,000 bonds at $90, the $1,000,000 notes at $88 and 139,000 shares of common stock at 50 cents per share, paying therefor the sum of $3;379,500 (R. 85, 217-218).

Out of this sum, Duquesne Gas Corporation paid the sum of $3,015,000 to the Central Hanover Bank & Trust Company representing the amount of Kingston Corporation's obligation to that bank which Duquesne Gas Corpo-

ration had assumed (R. 78, 82, 355, 356). The balance remained in the treasury of the Duquesne Gas Corporation (R. 78, 88).

As a result of these transactions, Furlaud & Company, Inc. and its subsidiary acquired every share of the common capital stock of Duquesne Gas Corporation, issued and outstanding, and every bond and note of that corporation, and the corporation did not owe to any other person any obligation of any kind. (R. 226).

No other person purchased from Duquesne Gas Corporation a single share of stock or a bond or a note.

In this transaction no fraud of any kind could have been perpetrated on Duquesne Gas Corporation because, as stated by the Trial Court:

> "At the time that the transactions through which Duquesne Gas Corporation acquired the various gas properties were consummated, and for some time thereafter, Furlaud & Company, Inc., owned every share of its capital stock, and ratified and approved of the whole transaction" (Judge Knox's Opinion, R. 231-232).

Were it not for the decision of the Trial Court, it would hardly seem necessary to cite authorities to establish the proposition that where the owners of property create a corporation, transfer their property to it, and receive in exchange all of the stock of that corporation and all of the bonds and notes ever issued by it, and, at the time of the transfer, no other person was interested in the corporation either as stockholder or creditor, no injury could result to any one whatsoever.

Under such circumstances, the corporation entered into the transaction with full knowledge of all facts. The ven-

dors and the vendee of the property so conveyed were one and the same, both in equity and in fact.

It seems abundantly clear that this Court in the case of *Old Dominion Copper Co.* v. *Lewisohn*, 210 U. S. 206, the Circuit Court of Appeals for the Second Circuit in the case of *Ball* v. *Breed*, 294 Fed. 227 (certiorari denied, 264 U. S. 584), and the Court of Appeals of the State of New York in the case of *Blum* v. *Whitney*, 185 N. Y. 232, have held and it is now the well established rule of law that neither a corporation nor its receiver has any cause of action against the organizers of such corporation for the recovery of profits made by such organizers either in the sale of properties to it or growing out of the sale of the securities of that corporation where the organizers, at the time of the transaction between them and the corporation, were the owners of all of the authorized and outstanding stock of said corporation.

It indubitably follows, therefore, that Duquesne Gas Corporation acquired no cause of action against any of these defendants on account of transactions which resulted in its organization and the original issue of its stock and securities.

If, therefore, this receiver had any cause of action against any of these defendants it must have resulted from some transaction other than those between the corporation and its organizers.

However, petitioner contends:

That before actually concluding the said transactions with Duquesne Gas Corporation, Furlaud & Company, Inc. organized a syndicate of which it became manager and from which it secured commitments to purchase certain portions of the bonds of Duquesne Gas Corporation, if, when and as issued (R. 73-74, 119-122, 178-180).

That this syndicate in turn organized a distributing group and issued circulars advertising these bonds which stated:

That they were secured by a mortgage covering properties which, including working capital of $365,000, had been appraised at an aggregate value of $7,038,000 (R. 224), and

That the appraisal made by Mattison, Davey & Winters was not a sound one and did not reflect the true value of the property and that, as a result of these additional facts, a cause of action did accrue to the corporation or to its Receiver.

We think we have shown in Point II of this brief that the admission of the testimony upon this subject was erroneous. The Trial Court, however, not only makes this testimony the basis of his opinion and decision but makes the following comment:

> "Defendants, it may be remarked, offered no evidence to rebut the conclusion that is compelled by Plaintiff's proof" (R. 224).

We feel constrained at this point to say that this case was actually on trial before defendants had any notice that the Petitioner intended to assert that any misrepresentations had been made to the purchasers of securities.

It would at that time have been impossible to have properly prepared to rebut the testimony offered without adjourning the trial.

The party who had made the appraisal were largely engaged in the southern and mid-continent oil fields (R. 71). In order to properly prepare for the trial of this issue, it would have been necessary for counsel to present their testimony and that of other engineers upon the question of the

value of these properties. It would also have been necessary to have prepared testimony, which counsel is advised could have been secured, to show the interest of the adverse witnesses and engineers in making it appear that the properties had as little value as possible. It would have been necessary to make a breakdown and analysis of the report of the certified public accountants to show the profits earned by these properties in 1929 and 1930 and to have presented a detailed record of the effect, not only upon Duquesne Gas Corporation but upon its customers who purchased large quantities of natural gas, of the depression in their business which was already apparent by the end of 1930.

Moreover, defendants were not only confident that all of the testimony offered upon the subject of overvaluation and misrepresentation was incompetent and irrelevant and immaterial but also, because of the fact that the Trial Court admitted practically everything that was offered, defendants were confident that in considering the testimony presented the learned Trial Court would exclude from his mind all such incompetent testimony. For these reasons and because they had no witnesses available with which to effectively meet this issue at that time, they elected to ignore this testimony.

Argument

If, for the purpose of this argument, we assume that the representations contained in these circulars were not in fact true and even that they were relied upon by the purchasers of the bonds and notes who acted upon such representations to their harm (although as we have shown there is no testimony to that effect in the record), we must then inquire what actionable injury resulted therefrom to the

corporation upon which this receiver could rely as a basis for a recovery against these defendants.

At the time of the sale of these properties by Kingston Corporation to Duquesne Gas Corporation, Furlaud & Company, Inc. owned all of the stock of Duquesne Gas Corporation. As the result of the sale of this property by Kingston Corporation, and the payment by Furlaud & Company, Inc. of a sum of money, Furlaud & Company, Inc. and its wholly owned subsidiary, Kingston Corporation, acquired every share of stock, every note and every bond ever issued by Duquesne Gas Corporation.

Mr. Justice Holmes in the case of *Old Dominion Copper Co.* v. *Lewisohn*, 210 U. S. 206, at page 212, says:

> "At the time of the sale to the plaintiff, then, there was no wrong done to anyone. Bigelow, Lewisohn, and their syndicate were on both sides of the bargain, and they might issue to themselves as much stock in their corporation as they liked in exchange for their conveyance of their land. * * * *If there was a wrong, it was when the innocent public subscribed. But what one would expect to find, if a wrong happened then, would not be that the sale became a breach of duty to the corporation nunc pro tunc, but that the invitation to the public without disclosure, when acted upon, became a fraud upon the subscribers from an equitable point of view, accompanied by what they might treat as damage. For it is only by virtue of the innocent subscribers' position and the promoter's invitation that the corporation has any pretense for a standing in court. If the promoters, after starting their scheme, had sold their stock before any subscriptions were taken, and then the purchasers of their stock, without notice, had invited the public to come in, and it did, we do not see how the company*

> *could maintain this suit. If it could not then, we do not see how it can now.*" (Italics ours.)

We think this statement of the law alone should have disposed of this case.

The Trial Court obviously confused the situation in this case with such as occurred in the case of *Gates* v. *Megargel,* 266 Fed. 811. The Trial Court in his opinion refers to this case and says:

> "In a sense, the situation is analogous to those in which promoters have been held liable for profits accruing to themselves through the misrepresentation of the true value of property conveyed to a corporation, when reliance upon such misrepresentation has been had by innocent purchasers of the stock of the corporation." (R. 221).

The distinction between the situation that existed in the *Megargel* case and that which exists in this case hardly requires further comment than the mere statement that in the *Megargel* case, suit was brought, not by the corporation or by its receiver, but by members of the syndicate. Obviously, in the cause of action referred to in that case, the syndicate members were the persons aggrieved and were not only the proper persons *but the only persons* who could maintain a cause of action growing out of such facts.

Petitioner, at page 22 of his brief, refers to *Yeiser* v. *United States Board & Paper Co.,* 107 Fed. 340, 344 (C. C. A. 6th 1901), and the case of *New Sombrero Phosphate Co.* v. *Erlanger,* L. R. 5 Ch. Div. 73, 46 L. J. Ch. N. S. 425, 36 L. T. N. S. 222, 25 Week. Rep. 436 (1877), and seems to contend that these cases limit the doctrine of the *Lewisohn* case.

Both of these cases were urged upon the Supreme Court in the *Lewisohn* case, and were disposed of by Mr. Justice Holmes on the ground that in those cases, at the very time that the promoters carried through their transactions, there were in existence innocent non-assenting stockholders to whom no disclosure of the true situation had been made. These cases are proper authorities to support the decision of *Davis* v. *Las Ovas*, 227 U. S. 80 which also involved the presence of innocent nonassenting stockholders at the very time that the transaction between the promoters and the corporation was closed but can have no application to a case in which the corporation had no dealings of any kind with any one other than its organizers.

In the case of *Ball* v. *Breed*, supra, one Tippenauer had by contract acquired options to purchase properties in Haiti. He entered into two contracts with certain bankers who organized a corporation known as the H. A. Company. By one of these contracts he agreed to transfer his options and holdings to the corporation in exchange for 60,000 shares of its common and founders' stock and the sum of $1,600,000—$500,000 in cash and the balance when a fund for that purpose should become available. By the second agreement, it was provided in effect that what Tippenauer was really to receive was $500,000 and 2500 shares of its common and 2500 shares of its founders' stock and that his rights to the remaining $1,100,000 and 55,000 shares of common and founders' stock should be transferred to the bankers, who were undertaking to finance the corporation. These agreements were executed on October 24th, 1916.

Immediately thereafter the bankers organized a syndicate of which the bankers were the syndicate managers

and to which the bankers were to sell if, when and as issued 55,000 shares of preferred stock of the said H. A. Company, 27,500 shares of common stock and 27,500 shares of founders' stock for the total price of $5,225,000.

The bankers thereupon made a call upon the syndicate of 20% and, as syndicate managers, received the sum of $1,050,000.00 in cash. In January, 1917 they organized the H. A. Corporation, in February, 1917, they subscribed for all of the preferred stock in their own name, utilized the amount which they received from the syndicate in providing the corporation with funds to pay Tippenauer his $500,000 and certain other sums which were required to organize the corporation amounting to $54,000 and to retain the amount of working capital that it was agreed the corporation should have. They used the credit of $1,100,000 to release the proportionate amount of preferred stock to which they were entitled under the agreement. By these means the Bankers acquired a sufficient amount of preferred stock, common stock and founders' stock with which to carry out their obligations to the syndicate and leave them a substantial profit.

The H. A. Company subsequently went into the hands of Receivers and the Receivers brought suit alleging that, as a result of these transactions, the Bankers had received a secret profit of $1,100,000 which they did not make known.

The Circuit Court of Appeals for the Second Circuit, says on page 231:

> "In the case at bar, suit is brought by the receiver on the theory that the profit made by the promoters was without knowledge and consent of the corportaion, and that the corporation does not consent, if any existing stockholder is ignorant of

the transaction and of the so-called secret profit. The ultimate fact upon which decision must rest is that the alleged secret profit was a matter of contract between Tippenauer and the bankers, and as these owned all the preferred and all of the common and all of the founders' stock which was either subscribed for or intended to be issued, there were no persons having any rights to receive stock from the corporation. Thus there were no innocent stockholders. In other words, there was no fraud upon the corporation."

Continuing at page 232, the Court very carefully distinguishes cases like *Davis* v. *Las Ovas*, 227 U. S. 80 from cases like this, saying of the *Las Ovas* case:

> "In *Davis* v. *Las Ovas*, 227 U. S. 80, 33 Sup. Ct. 197, 57 L. Ed. 426, the court held that, where the true consideration of a syndicate purchase is concealed, and the property is conveyed at a higher figure in shares of stock to a corporation *whose stock is held partly by members of the syndicate and partly by others*, and the necessary increase of shares to pay for the property goes to some of the syndicate promoters as a secret profit, the corporation may maintain an action to require those obtaining the shares to surrender them for cancellation." (Italics ours.)

Continuing, later on the same page:

> *"In the case at bar, there is no such state of facts. It is nowhere alleged as a fact, nor can it be inferred that there were any innocent stockholders at the time of the transaction complained of. If, then, there was a fraud, it was not against the corporation, and a cause of action, if any, is personal to the purchasers of the stock.* The fraud, if any, is what

has been called a subsidiary fraud not affecting the corporation. Allowing to the complaint the most favorable inference, all that can be said is, as concisely stated by the District Court, that:

> 'These transactions between the defendants and the subscribers to their syndicate had nothing to do with the formation of the corporation, the syndicate subscribers only agreed with the syndicate managers to take what the managers get for them, and they got it through the managers'." (Italics ours.)

Application was made to the Supreme Court of the United States for a writ of certiorari in *Ball* v. *Breed*, 264 U. S. 584. In the application for the writ and in the brief attached thereto the Petitioner urged the very question here presented upon the Supreme Court of the United States. On page IV of the Petition, the Plaintiff stated:

> "The two essential questions, more fully developed later, are: (1) Where a promoter enlists his syndicate subscribers, *puts their cash contribution into the corporation's capital, and thereafter sells property to it at a profit without disclosure of such profit to the corporation or to such subscribers, can he escape liability to account to the corporation for such profit, through the device of postponing the distribution of stock certificates to his subscribers until after the sale?* (2) Where a promoter disregards his established obligation as a fiduciary to disclose his profit to his syndicate subscribers and to his corporation, and even conceals such profit by false entries upon the corporation's books, is he immune from accountability to the corporation through merely having employed the device of inserting in his promotion documents a recital that his acquisition of stock for the syndicate will be by purchase from himself?" (Italics ours.)

On page IX of the Petition, the plaintiff contended:

> "Second, it (the decision of the Circuit Court of Appeals) fails to apply the principle established by this Court: that where the promoter of a corporation, before organizing the corporation, *enlists from various persons funds which are to form the corporation's capital, with which funds the corporation, when organized, buys property,* the promoter owes to such persons and to the corporation the duty to disclose fully the profit which he is making out of such sale of such property to the corporation." (Italics ours.)

The application for the writ was denied by this Court.

The Court of Appeals of the State of New York in the case of *Blum* v. *Whitney,* 185 N. Y. 232, at page 244, quotes from the case of *Tompkins* v. *Sperry, Jones & Co.,* 96 Md. 560, as follows:

> "It is a misuse of terms in the present case to say that Sperry and Jones stood in a fiduciary relation to the company at the time they made the contracts with the brewers, or when they turned property into the company in payment of its stock and bonds. *They at that time held all of its stock and were the sole owners of the company. They were in equity the company itself."* (Italics ours.)

Even in the State of Massachusetts where the rule on this general subject is not in complete harmony with the Federal rule, it is now well settled that a corporation cannot recover profits made by promoters in selling to it their own property, provided such promoters are or become the original subscribers of *all of the shares of capital stock contemplated as a part of the scheme of promotion, as is admittedly true in this case.*

Hays v. *The Georgian,* 280 Mass. 10.

In that case, speaking of the decision of the lower Court, the Supreme Court of Massachusetts says (p. 20):

> "In substance and effect, this is a succinct statement of the principle that, if the promoters and those acting in concert with them, are the *original subscribers to the entire capital stock contemplated to be immediately issued and they then sell those shares, without disclosure of the profits of the promoters to outside parties, there is no fraud on the corporation* and no ground for complaint by it even though the promoters may derive large profits from the transaction." (Italics ours.)

Later on in its opinion in the *Hays* case, the Court says (p. 21):

> *"Where one is not an original subscriber to stock, but purchases shares from a broker or other vendor of stock, the corporation is not a party to the transaction."* (Italics ours.)

See also:

Mile Wide Copper Co. v. *Piper,* 29 Ariz. 129;
Allenhurst Park Estates v. *Smith,* 101 N. J. Eq. 581;
Hoffman Motor Truck Co. v. *Erickson,* 124 Minn. 279;
Higgins v. *Lansingh,* 154 Ill., 301;
Tompkins v. *Sperry, Jones & Co.,* 96 Md. 560;
Hamilton v. *Hamilton Mammoth Mines,* 110 Or. 546;
Turner v. *Markham,* 155 Cal. 562;
Seymour v. *Spring Forest Cemetery Association,* 144 N. Y. 333;
Wells v. *Northern Trust Co.,* 195 Ill. 288.

The Trial Court, however, disregarding all of these authorities, finds that purchasers from Furlaud & Company, Inc. of the securities so issued by Duquesne Gas Corporation were induced to part with their money in exchange for these securities by reason of alleged misrepresentations and that as a result thereof, somehow—a trust in favor of the corporation resulted (R. 228).

In this connection, he cites the cases of *McKee* v. *Lamon,* 159 U. S. 317, and *Sayer* v. *Wynkoop,* 248 N. Y. 54 (R. 227). An inspection of these cases reveals the fact that in both cases money, admittedly due to the plaintiff, was by his debtor turned over to a third party to be paid to that plaintiff.

In *McKee* v. *Lamon, supra,* a fund was turned over to McKee in trust, requiring him *"to pay over to all parties* who have rendered services heretofore in the prosecution of this claim *the amount due to such persons".* Here, McKee became an express trustee and all that was necessary for the beneficiary to do was to establish his right to participate in the trust fund. The money in controversy was owing to him, and the Court, after fixing the amount due him, declared that he was entitled to receive it from the fund created for the very purpose of paying him and others similarly situated.

In the *Sayer* case, money was due to an insurance company as premiums on its policies and the debtor made payment to his broker with instructions to pay those premiums. Here again the status of creditor existed in the plaintiff who brought suit for these premiums.

In each case, a property right existed in favor of the plaintiff in the fund delivered to the trustee for the very purpose of satisfying his claim.

We do not desire to be understood as contending that it is only where the relation of debtor and creditor exists that money paid to another for the benefit of a third person can be impressed with a trust for the benefit of such third person.

Certainly where a gift is made to such third person in this manner, where a bequest is created for the benefit of a third person, and where in any manner an interest in a trust estate is created for the benefit of a third person, such third person acquires the right to enforce such a trust.

What we do contend is that in order that a trust in favor of a third person can come into existence such third person must have or become entitled to an interest or a property right in the trust fund.

We are unable to see any analogy between the cases cited by the Trial Court and the facts of this case. No person delivered any property or money to Furlaud & Company, Inc., with instructions to pay or deliver the same to Duquesne Gas Corporation.

What happened was that Furlaud & Company, Inc., purchased certain securities from Duquesne Gas Corporation and paid that corporation for them.

It, Furlaud & Company, Inc. in turn sold some of the securities so purchased by it to third parties and the third parties paid it for the securities so purchased.

Next, the Trial Court says that the receiver had the right to bring such suit because he represents not only the corporation but all those having an interest in its property as well. He says:

> "A receivership is for the benefit and protection of all interests, general creditors, secured creditors (bondholders) and stockholders, and it is the

> duty of the court, so far as reasonably possible, to conserve and protect all interests" (R. 229).

Of course we agree with this language in so far as it refers to the property of the corporation which comes into his hands as receiver. As to such property he is a trustee. All of those interested in that property are beneficiaries of the trust, and it is an elementary proposition of law that in the administration of his trust a trustee represents and should protect the interest of all of his *cestui que trustent.*

The Trial Court further states:

> "Although it may be that Duquesne Gas Corporation might not be able, in its own right, to hold Furlaud and Company, Inc., and its masters to accountability for the fraud that was here worked, simple justice requires that the receiver, in his representative capacity, should be able to vindicate the rights of creditors who were victimized" (R. 229).

Just how did the receiver of Duquesne Gas Corporation acquire the right or power to bring suit to vindicate the personal rights of the individuals who became bondholders or noteholders of Duquesne Gas Corporation?

The complainant does not contend that he was appointed Receiver of the personal rights of any individual.

Nor does he contend that any individual assigned his or her rights to him.

Moreover, it does not even appear that any one had rights to be vindicated.

The jurisdictional facts necessary to establish a cause of action on behalf of any of these bondholders or noteholders have neither been alleged nor proven.

The Court merely assumes that some one must have been misled.

Is it not elementary that in order to establish a cause of action for fraud, it is necessary to allege and prove not only (1) that certain representations were made, *but* (2) *that they were false, and* (3) *that they were material? Is it not also essential to show* (4) *that the purchaser relied upon such representations and believed them to be true, and* (5) *acted upon them, and* (6) *that but for such reliance the persons aggrieved would not have entered into the engagement complained of?*

We insist that insofar as the record in this case discloses the facts, no person is shown to have had any rights to be vindicated.

Is it not also true that even if a cause of action did accrue to some one, the person aggrieved had an election of remedies? Had he not the right to go before a Court of Equity to rescind the contract complained of if he so elected? Had he not the right to bring an action at law if he so elected? Does not each person so aggrieved have the separate right to make such election as in his own unrestricted judgment is in his own best interests?

Is not such cause of action personal to each individual aggrieved?

As early as 1885 in the case of Foster v. Seymour, 23 Fed. 65, this question was disposed of.

Wallace, *J.*, in the well considered opinion in that case, states (p. 65):

> "The bill alleges, in substance, that the whole capital stock of the corporation, which was fixed and limited by the certificate of incorporation of the company at 100,000 shares of $100 each, was exchanged by the trustees of the corporation in payment for the purchase of mining property owned by the trustees personally, or some of them,

the value of which did not exceed $100,000 as the trustees knew."

Continuing, he says (p. 66):

"The transaction as alleged was a fraud upon the public. It was equivalent to an overissue of stock by a corporation to its stockholders. It was calculated to lead parties, dealing with the corporation in ignorance of the facts, to believe that it had a paid-up capital stock of $10,000,000, and representing a corporate fund of that amount invested in mining property. By putting out the scrip the trustees represented to the public, who have no means of knowing of the private contracts made between a corporation and its stockholders, that the capital stock had been subscribed for and paid in. It was not a fraud upon stockholders, however, because there were none; nor necessarily upon persons subsequently becoming stockholders, because the stock was full-paid stock, and not liable to any further calls in the hands of those who might purchase it. *Scoville* v. *Thayer*, 105 U. S. 143. *A purchaser of the stock would not be injured by the transaction unless he paid more for it than it was worth; and every purchaser would stand upon the particular circumstances of his purchase.*" (Italics ours.)

In view of the foregoing authorities, we respectfully submit that we can see nothing in the Complaint alleging nor in the evidence establishing any cause of action in favor of Duquesne Gas Corporation, or its Receiver, against any of the Defendants.

POINT IV

UNDER THE FACTS OF THIS CASE THE PLAINTIFF IN HIS CAPACITY OF RECEIVER HAS NO GREATER RIGHTS OR POWERS THAN THE CORPORATION ITSELF WOULD HAVE.

Petitioner contends, under his fourth point, that the plaintiff in his capacity as receiver and standing in the right of the creditors has the right to disaffirm the acts of the corporation.

He refers to a number of cases where fraud was perpetrated upon a corporation and upon its stockholders by a Board of Directors who were under the control of some of its stockholders.

In all of these cases, at the time of the transaction complained of, there were innocent stockholders or creditors in existence who had not consented to the improper conduct of the Board (as in the case of *Leach* v. *Grant,* 54 F. (2) 731, *Davis* v. *Las Ovas, supra,* and *Casey* v. *Cavaroc,* 96 U. S. 467). The law upon this subject has always been well settled and it is to the effect that the directors of a corporation are trustees for the corporation and as such are trustees for its stockholders and creditors. Any act of theirs in violation of their obligation as trustees is, of course, actionable. We have shown under the third point of this brief that under the facts of this case no such relationship existed or could have existed as a matter of law.

See

Ball v. *Breed, supra;*
Ball v. *Chapman,* 1 F. (2d), 895;
South Penn Collieries Co. v. *Sproul,* 52 F. (2d) 557;
Tompkins v. *Sperry, Jones & Co.,* 96 Md. 560.

Moreover, as we have shown under the first and second points of this brief, there is no allegation in the complaint in this case that charges that any wrong was practiced on any one.

POINT V

THE CONTENTION OF THE PETITIONER THAT THE CORPORATION WAS POWERLESS TO RENDER ITSELF INSOLVENT BY A SURRENDER TO THE DEFENDANTS OF ITS RIGHT TO HOLD THEM ACCOUNTABLE TO IT FOR THE PROCEEDS WHICH CAME INTO THE HANDS OF DEFENDANTS FROM THE SALE OF THE SECURITIES OF THE CORPORATION, IS NOT ONLY NOT WITHIN THE ISSUES PRESENTED BY THE COMPLAINT, BUT UNDER THE FACTS OF THIS CASE IS UNSOUND.

We feel constrained to again call the Court's attention to the fact that there is no allegation in the complaint which raises the issue with which Point V of the petitioner's brief is concerned, even if it were sound. We have discussed this question under Points I and II.

Ever since the decision of this Court in the *Lewisohn* case, every conceivable argument has been advanced to evade its effect. The case of *Davis* v. *Las Ovas, supra,* is in no sense and in no part in conflict with the decision in the *Lewisohn* case.

In the *Lewisohn* case it was held that where, as the result of transactions between promoters and a corporation, the promoters acquired *all of the stock of such corporation* no disclosures of the cost of the property transferred were

required because the promoters were merely selling to themselves and as purchasers knew all of the facts involved in the transaction.

The *Las Ovas* case holds that where at the time of the transaction complained of the promoters *did not acquire or have all of the existing issued stock of the corporation,* or, in other words, if there were at that very time innocent interested stockholders of the corporation in existence, the obligation to make full disclosures did exist. The *Las Ovas* case has been used as the basis for innumerable arguments to the effect that parties who have contracted to become stockholders and bondholders and have actually advanced or agreed to advance money to the promoters in exchange for securities to be sold to them by such promoters if, as and when issued, became by reason of their contractual relationship equitable parties in interest. The action of this Court in refusing to grant a writ of certiorari in the case of *Ball* v. *Breed, supra,* in the application for which this very question was so vigorously urged, seems to us to dispose of that question.

The precise question here involved has been decided in a number of cases. We will content ourselves with quoting from two.

In *Wells* v. *Northern Trust Co.,* 195 Ill. 288, the Construction Company to whom the bonds and stock were issued originally received $15,000,000, half in stock and half in bonds of the company, but the cost of building and equipping the entire road was $7,728,102.94. This company was insolvent. The Court said (p. 296):

> "It is not shown that there were then any stockholders or creditors who were injured by this action against their consent. All then interested in the

> company, having assented to the contract and its modifications, and to the mortgage and the issuing of the bonds, the company and the successors in interest of the then stockholders are estopped from setting up the inequality or oppressiveness of the construction company's contract."

In the case of *Seymour* v. *Spring Forest Cemetery Association,* 144 N. Y. 333, the Court, after discussing this very question, uses the following language (p. 340):

> "Evidence was given to show that the land conveyed was not worth the sum secured, but that is a totally immaterial fact. Whatever the price, it wronged no one and could wrong no one, and accomplished nothing except to fix a primary limit to the anticipated profits."

POINT VI

THE QUESTION PRESENTED BY PETITIONER UNDER POINT VI OF HIS BRIEF, HAVING BEEN RAISED FOR THE FIRST TIME UPON THE SECOND ARGUMENT OF THE APPEAL OF THIS CASE, COULD NOT IN ANY EVENT BE CONSIDERED BECAUSE

(1) There is no allegation in the complaint under which this issue, if sound, could have been raised;

(2) It is in direct conflict with the theory upon which the case was tried in the lower court.

Under Point VI of the petitioner's brief he contends that all of the securities issued by Duquesne Gas Corpo-

ration were void under the Pennsylvania Constitution; that the defendants at no time were in the position of stockholders, bondholders or noteholders of the corporation.

As a matter of fact, none of the defendants in this case except Kingston Corporation ever acquired a single share of stock, a bond or a note from Duquesne Gas Corporation, so as to them the question if otherwise sound could not be asserted.

1.

We will not here discuss the soundness of the proposition advanced by petitioner beyond saying that one of the leading cases in America following the rule laid down in the *Lewisohn* case, is the case of *South Penn Collieries Co.* v. *Sproul,* 52 F. (2nd) 557, which involves a Pennsylvania corporation.

We will content ourselves here with calling the attention of this Court to the fact that this question was first presented on the second argument before the Court of Appeals. Nor shall we here make extensive reference to the fact that there is no allegation in the complaint under which this theory could have been considered by the lower court or by the Court of Appeals.

Counsel for petitioner has so often asserted in his briefs and arguments that the fiduciary relationship which he claimed between some of the defendants and Duquesne Gas Corporation arose out of the representations made by them or some of them, or by corporations dominated by some of them, to the purchasers of these securities that we were constrained to believe that that was the theory upon which he was relying.

2.

Petitioner's statement in his first brief as respondent in the Court of Appeals in which he states as the basis of the judgment entered in favor of the complainant, is as follows:

> "That when a banker or promoter assures the purchasers of corporate bonds that the proceeds of sale are to be turned over to the corporation or used for its benefit, he is bound to make that assurance good; that when the bondholders contribute money on the face of such assurances a trust relation arises of which the corporation is the beneficiary; that the corporation has an enforceable right to receive the benefit of the proceeds of the bonds. This is a property right and it cannot be given away to the prejudice of creditors, even with the consent of all the stockholders. If the right is given away, or, to put it more bluntly, if the proceeds of the bonds are converted by the promoters to the prejudice of the creditors of the corporation, the receiver of the corporation can maintain an action to recover the moneys so converted, though the unanimous consent of the stockholders might have barred an action by the corporation."

It must be remembered that the only representations that he alleges were made were to the effect that the securities were or are issued in connection with the acquisition of property and to provide working capital for the corporation. He does not even allege that that representation was not true, but true or false, he insisted that as a result of that statement the relation of trustee was impressed upon Furlaud & Company, Inc. He nowhere alleges that

the securities issued were in excess of the value of the property, but he does show the cost of the property.

From the beginning of the trial petitioner has absolutely disregarded the allegations in his complaint. He has treated it as a mere scrap of paper having no function but to mislead defendants as to the basis of his claim.

In the lower court he succeeded in introducing evidence indicating that the value of the properties, though admittedly in excess of their cost, was much less than the price for which they were appraised. We think we have shown under Point II of our Brief that the admission of this testimony constituted reversible error. We most strenuously objected to it and exceptions were taken and allowed.

But even then the petitioner never advanced any other theory than that hereinbefore set out as representing his theory in this case.

If there be any basis for the rule that in an appellate court a party is bound by the construction he puts upon his pleadings in the lower court and upon the theory of fact upon which he there submitted his cause or defense, how can the defendant upon his second brief and argument before an appellate court for the first time present an entirely new theory not suggested in his complaint and never urged or relied upon by him before?

In *Texas & P. R. Co.* v. *Abilene Cotton Oil Co.*, 204 U. S. 426, this Court very definitely holds that an intermediate Appellate Court cannot consider a theory different from that upon which a case had been tried in the lower court.

In *Rees* v. *Lombard*, 21 F. (2d) 276, the Circuit Court of Appeals of the Ninth Circuit says (277):

> "* * * The rule is well settled that, in an appellate court, a party is bound by the construction he put

> upon his pleading in the lower court, and the theory of fact upon which he there submitted his cause or defense."

In *Ehmen* v. *City of Gothenburg, Neb.* 200 Fed. 564, at 566, the Circuit Court of Appeals for the Eighth Circuit says:

> "It would be manifestly unjust, when a case has been narrowed to an issue by pleadings and trial, and a bill of exceptions submitted and allowed to present the ruling of the trial court, for an appellate court to entertain a new and different question on the merits."

See also:

Albany Perforated Wrapping Paper Co. v. *John Hoberg Co.*, 109 Fed. 589;
Lesser Cotton Co. v. *St. Louis I. M. & S. Ry. Co.*, 114 Fed. 133;
Van Norden v. *Chas. R. McCormick Lumber Co.*, 17 F. (2d) 568;
Roof v. *Rule*, 348 Ill. 370;
Svenson v. *Svenson*, 178 N. Y. 54.

The Supreme Court of the United States in reversing the decision of the Circuit Court of Appeals for the Second Circuit on the former appeal in this case (*McCandless* v. *Furlaud*, 79 L. Ed. 32) most emphatically recognized this doctrine. Although in that case the question of the title of plaintiff was put in issue by what this court held to be a constructive denial this Court held that that question could not for the first time be raised in an Appellate Court.

POINT VII

THE TRIAL COURT PROPERLY DISMISSED THE COMPLAINT AS TO THE DEFENDANTS BYRON CORPORATION AND CHAUCER CORPORATION.

Byron Corporation and Chaucer Corporation had dealings solely in the stock of the Duquesne Gas Corporation.

The Trial Court dismissed the complaint as to these two defendants on the authority of *Old Dominion Copper Co.* v. *Lewisohn,* 210 U. S. 206 (R. 232).

Byron Corporation and Chaucer Corporation were organized in May of 1930.

The stockholders of Byron Corporation were Eleanor Mortimer Furlaud and Kipling Corporation who owned 10,000 and 30,000 shares of its stock respectively (R. 109). Eleanor M. Furlaud is the wife of the defendant Maxime H. Furlaud (R. 103). It does not appear who were the stockholders of Kipling Corporation.

Chaucer Corporation was organized at about the same time. The stockholders of that corporation were Elsie Reuter and Virgil Corporation who owned 10,000 and 30,000 shares of its capital stock respectively (R. 112).

Elsie Reuter is the wife of Carlos Reuter (R. 103). It does not appear who were the stockholders of Virgil Corporation.

Byron Corporation and Chaucer Corporation had acquired options to purchase from Kipling Corporation 255,000 shares each of the common capital stock of Duquesne Gas Corporation for 50 cents a share (R. 101-102).

Subsequently and on or about the 27th day of May, 1930 these options were exercised and notes were executed by both these corporations to Kingston Corporation in

the sum of $127,500 each payable with interest at 6 per cent. These notes were thereafter paid and Kingston Corporation received from Byron and Chaucer Corporations approximately $265,000 in payment for the stock (R. 102, 125).

On May 29, 1930 an agreement was entered into between Chaucer Corporation, Byron Corporation and John J. Bergen (R. 97, 200-201). Under this agreement Mr. Bergen obtained an option to purchase all or any part of 100,000 shares of the common stock of Duquesne Gas Corporation at $10.00 per share, a further option to purchase all or any part of an additional 150,000 shares at $12½ per share and a further option to purchase 50,000 shares at $14 per share. Subsequently Mr. Bergen purchased under this option agreement 42,500 shares from Byron Corporation and paid therefor the sum of $425,000 (R. 96).

There is no testimony in the record which indicates that any other shares were sold to Bergen or that any other sums of money were received by Byron Corporation or Chaucer Corporation from him or from any one else.

On the basis of these facts the Court properly dismissed the complaint as to Byron and Chaucer Corporations.

There is no testimony of any kind in any way connecting these corporations with any of the transactions complained of by petitioner. It is in evidence that Mrs. Furlaud owned 25 per cent. of the stock of Byron Corporation and that Byron Corporation bought and paid for 255,000 shares of Duquesne Gas Corporation stock. Three-quarters of the stock was owned by another corporation concerning the ownership of which no evidence was offered. Elsie Reuter occupied the same position towards the Chaucer Corporation. There is no evidence which in any manner connects either Mrs. Furlaud or Mrs. Reuter with any of the trans-

actions referred to herein or that they knew of any of the facts complained of by the petitioner.

The corporation in which each of them was interested purchased this stock at a price in excess of any value placed upon it by the petitioner. Petitioner contends that the Duquesne Gas Corporation was insolvent and that its stock had no value of any kind. The stock had no par value and at most represented the equity in the properties of Duquesne Gas Corporation in excess of its bond and note indebtedness.

We respectfully submit that not only did the Court properly dismiss the complaint as to these corporations for the reasons given by him but that in addition there was no evidence of any kind offered to the effect that these corporations were not perfectly innocent purchasers for value of the securities purchased by them.

POINT VIII

THE DEFENDANT FURLAUD IS NOT PERSONALLY LIABLE IN THIS CASE IN ANY EVENT.

Under Point VII of his brief, the petitioner contends that "the defendant Furlaud is personally accountable for the fraudulent misappropriation."

The Court of Appeals held on the basis of undisputed evidence that:

> "Maxime H. Furlaud had no relation to these transactions other than as an officer and director of Furlaud & Co. Inc., and his personal activity in carrying on the negotiations and transactions. He did not participate in the alleged fraudulent appraisal or receive personally any of the monies paid to Furlaud & Co. Inc." (R. 267).

It nowhere appears in the record that Furlaud personally received any of the funds paid to Furlaud & Co. Inc.

The petitioner relies on the case of *Anderson* v. *Daley*, 38 App. Div. 505, which is a case involving the actual misappropriation of trust funds that came into the possession of a corporation. The President of the corporation was a party to the misappropriation and he was held liable as a trustee *de son tort*. However, as we have shown before, no trust funds ever came into the possession of Furlaud & Company, Inc. It merely sold some bonds and notes to various people who purchased them.

POINT IX

THE COMPLAINT AFFIRMATIVELY SHOWS THAT COMPLAINANT HAD NO TITLE TO ANY CAUSE OF ACTION THAT COULD HAVE BEEN ASSERTED BY DUQUESNE GAS CORPORATION.

The attention of the Court is here for the first time called to the fact that:

In paragraph "Second" of complainant's amended complaint (R. 4) he alleges that he is a resident and citizen of the Commonwealth of Pennsylvania and that Duquesne Gas Corporation is a corporate citizen of the Commonwealth of Pennsylvania, and,

In paragraph "Fourth" (R. 4-5) he alleges that upon petition of complainant filed in the United States District Court for the Southern District of New York an order was duly made appointing such complainant ancillary receiver of Duquesne Gas Corporation.

In its decision in the case of *McCandless* v. *Furlaud*, 79 L. Ed. 32, this Court said, referring to the case of *Booth* v. *Clark*, 17 How. 322 (p. 36):

> "There, the foreign equity receiver suing in the federal court of another State failed because, having no title to the assets within the district, he was without a cause of action.. * * * For that reason, a bill in the federal court for southern New York brought by the primary receiver, alleged to have been duly appointed in Pennsylvania and authorized to bring this suit, would have been bad on demurrer. But this bill by the ancillary receiver, which alleges that he had been duly appointed by the federal court for New York and authorized to bring the suit, would have been good on demurrer."

Ordinarily we would assume that the decision of this Court in the case of *McCandless* v. *Furlaud, supra,* disposes not only of any issues that were presented but of any that might have been.

However, this Court in the case of *Mitchell* v. *Maurer*, 79 L. Ed. 149, decided subsequent to the decision in the *McCandless* case, *supra,* held that the appointment of the Receiver in that case was void for lack of diversity of citizenship, although the question was not raised either in the lower court or in this Court. Mr. Justice Brandeis, speaking for the Court, says (p. 153):

> "Unlike an objection to venue, lack of federal jurisdiction cannot be waived or be overcome by an agreement of the parties. An appellate court must satisfy itself not only of its own jurisdiction, but also of that of the lower courts in a cause under review. *Mansfield, C. & L. M. R. Co.* v. *Swan*, 111 U. S. 379, 382, 28 L. ed. 462, 463, 4 S. Ct. 510. Hence,

> the failure of the Insurance Commissioner to claim, in his petition for certiorari, that the order of the District Court was void for lack of federal jurisdiction of the suit, and his failure otherwise to call to the attention of this Court the lack of diversity of citizenship are immaterial."

In view of this decision we feel it our duty to our clients as well as to this Court to call attention to the fact that it affirmatively appears from the pleading in this case that the appointment of complainant as ancillary receiver was void. The complaint shows that the appointment was made on the petition of a citizen of the Commonwealth of Pennsylvania to have an ancillary receiver of the Duquesne Gas Corporation, also a corporate citizen of the State of Pennsylvania, appointed. That the Duquesne Gas Corporation was a necessary party to any proceeding to have a receiver of its assets appointed seems too clear for argument.

In view of the fact that in its former decision this Court distinguished a case where a defect in petitioner's title appears upon the face of the complaint from one in which it is merely constructively raised by answer, and in the *Maurer* case expressly held that where the lack of federal jurisdiction consisted of the lack of diversity of citizenship the matter was one that not only could not be waived but which the Court would of its own motion investigate, we feel constrained to call this Court's attention to these allegations in the complaint, but unless requested so to do shall not further discuss the question involved.

CONCLUSION

The judgment of the United States Circuit Court of Appeals for the Second Circuit, filed March 11, 1935, should be affirmed.

Respectfully submitted,

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IRA W. HIRSHFIELD,
LOUIS J. ALTKRUG,
Of Counsel.

October, 1935.

APPENDIX

In the appendix to his brief the plaintiff discusses the doctrine enunciated in the cases of *Old Dominion Copper Mining and Smelting Company* v. *Lewisohn,* 210 U. S. 206, and that enunciated in *Old Dominion Copper Mining and Smelting Company* v. *Bigelow,* 203 Mass. 159.

It is true that upon the question which is involved in the decision of the *Lewisohn* case there are two lines of authorities in this country. One is known as the "Federal rule" and the other as the "Massachusetts rule".

As a corollary to the rule adopted in the *Lewisohn* case, it was held in *Davis* v. *Las Ovas,* 227 U. S. 80, that where at the time of the transaction between promoters and a corporation, the promoters were *not the owners of all of the stock of the corporation,* there was a duty of disclosure to innocent existing stockholders. There is not the slightest conflict between these decisions. The decision in the latter case follows obviously and naturally from the decision in the former.

The Massachusetts rule was, by the case of *Hays* v. *The Georgian,* 280 Mass. 10, so clarified that the Massachusetts rule now is that where at the time of the transaction complained of the promoters *are the original subscribers to the entire capital stock contemplated to be immediately issued,* the corporation did not and could not have any cause of action against them.

Since in this case there can be no question whatever of the fact *Furlaud & Company, Inc. and Kingston Corporation were the original subscribers to the entire capital stock contemplated to be immediately issued,* we do not think that the discussion is pertinent.

Moreover, we do not think that the analysis of the cases made in petitioner's Appendix is justified. For instance, petitioner refers to such cases as *Yeiser* v. *U. S. Board & Paper Co.*, 107 Fed. 340, *New Sombrero Phosphate Co.* v. *Erlanger*, L. R. 5 Ch. Div. 73, 46 L. J. Ch. N. S. 425, 36 L. T. N. S. 222, 25 Week. Rp. 436, and cases like *Tilden* v. *Barber*, 268 Fed. 587 and *American Shipbuilding Co.* v. *Commonwealth S. S. Co.*, 215 Fed. 296 as cases based on the theory that the promoters were in the position of trustees to future stockholders of the corporation.

An examination of these cases shows that the decision of the Court was based upon a complete realization of the distinction first announced by this court in the cases of *Old Dominion Copper Co.* v. *Lewisohn* and *Davis* v. *Las Ovas.* For instance, in the case of *Tilden* v. *Barber*, the court after holding that Barber was not a trustee to the millers for the reasons set out, spoke of the subscriptions made by the public and uses this language, (p. 602):

> "To such of them as had subscribed for the stock of this company, *and had paid a portion of the amount due on their subscription at the time Barber's proposal was accepted by his dummy directors* (and there were a number of such subscribers), he owed the duty of making a full disclosure, or, failing in that, to make it to an independent and competent board of directors of the company when formed" (Italics ours).

In the case of *American Shipbuilding Co.* v. *Commonwealth S. S. Co.* speaking of the facts in that case, the Court said (p. 299):

> "What they did do was to proceed exactly as planned, organize the corporation, exchange their

> subscription rights for capital stock, and then, as a corporation, take over and complete the contract which their agent had made."

Here again there were actual interested innocent stockholders at the time the transaction was completed.

Petitioner refers to the case of *Humble Oil Co.* v. *Campbell*, 69 F. (2d) 667. That is a case of a trustee selling the title to property belonging to others and not accounting to his *cestui que trust* for the proceeds of the sale, and the Court expressly says, in speaking of the facts of that case and of the Federal rule (p. 670):

> "It is not necessary to determine under which line of decisions this case falls. It is maintainable upon the broad powers of a trustee to follow and gather in trust property, and hold to an account those who have taken it."

Nor can we understand petitioner's statement that in cases like *Ball* v. *Breed*, 294 Fed. 227, *South Penn Collieries Company* v. *Sproul*, 52 F. (2d) 557 and *Johnson* v. *Louisville Trust Co.*, 293 Fed. 857, the decisions were ultimately based upon the fact that no fraud was actually practiced by the promoters. If he means that no fraud was actually practiced by the promoters on the corporation, because they were the corporation, that they sold to themselves and could not practice fraud upon themselves, of course we agree with him, but certainly in the case of *Ball* v. *Breed* a profit of $1,100,000 was taken by the bankers and it was not disclosed to their associates in the syndicate whose money they used in organizing the corporation.

In the *South Penn Collieries* case, Sproul and Jackson acquired properties for $384,000 which they resold to the South Penn Collieries Co. for $700,000, thus making a net

profit of $316,000 in the first transaction, and in the second transaction made an additional profit of $217,666.67.

We further regret to say that we cannot construe many of the cases cited by counsel for petitioner in his Appendix as standing for the proposition claimed for them.

Of the cases cited by the petitioner three others seem to have no possible application to the question.

In *Downey* v. *Byrd,* 171 Ga. 532, three stockholders sued the promoters to recover the purchase price of stock issued to them by a corporation on the ground that the defendant promoters had by fraud and deceit caused them to purchase stock. This case obviously does not involve a question of promoters' profits, but a simple case of fraud and deceit.

In *Land Co.* v. *Lewis,* 101 Me. 78, a corporation sought an adjudication that the defendants were holding the legal title to land as trustees for the corporation and to compel a conveyance of the property to the company. The defendants, who were its officers, had diverted the company's monies and had purchased property with such funds. These funds were traced into land purchased by the defendants. The corporation was held entitled to impress a trust upon these lands to the extent of its interest therein.

In *American Forging Co.* v. *Wiley,* 206 Mich. 664, an action was brought by the corporation to compel a promoter to perform a contract entered into by him for the benefit of the corporation and which he had failed to perform. This court does state that it adopts the Massachusetts rule, but its application to the facts is difficult to understand.

In quite a number of the cases cited by Petitioner in the Appendix to his brief, the Federal rule as announced in *Davis* v. *Las Ovas* is followed. The decisions in those cases are not in conflict with the case of *Old Dominion Copper*

Co. v. *Lewisohn*. Under the facts as disclosed, the *Lewisohn* case does not apply.

As we have hereinbefore stated, there are a number of state court cases which have adopted the Massachusetts rule but we think that far the greater number of state courts have adopted the federal doctrine.

In 1 Fletcher on Corporations (Perm. Ed. 1931) at page 648, the author in discussing the *Lewisohn* and *Bigelow* rules states that:

> "The marked tendency of the State Courts has been to follow the United States Supreme Court."

Ehrich, in his work on Promoters at page 265, says:

> "If one may be permitted to express an opinion on the merits of the question upon which the highest courts in the land disagree, it is, after much hesitation, suggested that the decision of the Supreme Court of the United States is on the whole to be preferred."

The following authorities have adopted the rule as laid down in the *Lewisohn* case:

Hughes v. *Cadena de Cobre Min. Co.*, 13 Ariz. 52;
Garretson v. *Pacific Crude Oil Co.*, 146 Calif. 184;
Lilylands Canal & Reservoir Co. v. *Wood*, 56 Colo. 130;
Soule v. *Kunkle*, 71 Colo. 221;
Higgins v. *Lansingh*, 154 Ill. 301;
Wells v. *Northern Trust Co.*, 195 Ill. 288;
St. Louis F. S. & W. R. Co. v. *Tiernan*, 37 Kan. 606; 633;

Hoffman Motor Truck Co. v. *Erickson*, 124 Minn. 279;
American Barley Co. v. *McCourtie*, 150 Minn. 460;
Tompkins v. *Sperry, Jones & Co.*, 96 Md. 560;
Seymour v. *Spring Forest Cemetery Association*, 144 N. Y. 333;
Blum v. *Whitney*, 185 N. Y. 232;
Roberson v. *Draney*, 53 Utah 263;
Inland Nursery & Floral Co. v. *Rice*, 57 Wash. 67;
Metcalfe v. *Mental Science Ind. Ass'n*, 127 Wash. 50, 56 *et seq.*

We do not here cite many cases like that of *Hays* v. *The Georgian*, 280 Mass. 10, because they do not completely adopt the rule laid down in the *Lewisohn* case, but as an evidence of the trend of the courts we call attention to the fact that even Massachusetts through its highest court has held that if at the time of the transaction complained of "the promoters and those acting in concert with them are the original subscribers to the entire capital stock *contemplated to be immediately issued* and they then sell those shares, without disclosure of the profits of the promoters, to outside parties, there is no fraud on the corporation and no ground for complaint by it even though promoters may derive large profits from the transaction. That principle seems to prevail generally." (Italics ours.)

However, we feel that any discussion of the advisability of following the *Bigelow* case in the determination of the issues before this Court is hardly pertinent, first because this Court decided both the *Lewisohn* case and the *Las Ovas* case and we must assume that those cases announce the law

on this subject, and second, because even under the Massachusetts rule plaintiff could not recover under the facts of this case, for the reason that at the time of the transaction complained of Furlaud & Company, Inc. and Kingston Corporation became original subscribers to the entire securities contemplated to be immediately issued, and if they then sold those securities *without disclosure of their profits to outside parties* there could be no fraud upon the corporation, no ground for complaint by it even though they may have derived large profits from the transaction.

We have gone to this length in discussing the appendix in our opponent's brief in order not to create the impression that we concede that the cases referred to by him stand for the propositions suggested.